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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NO. 1047 106

WASHINGTON COUNTY FIRE INSURANCE COMPANY, Washington, Pennsylvania,
Petitioner,

v.

WILLIAM DRISCOLL, Collector of Internal Revenue, 23rd District of Pennsylvania, Pittsburgh, Pennsylvania, Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

May it Please the Court:

The petition of Washington County Fire Insurance Company respectfully represents to your Honorable Court:

Summary Statement of the Matter Involved.

This is an action at law instituted by petitioner in the United States District Court for the Western District of Pennsylvania against respondent to recover income taxes and interest thereon for the calendar years 1928 to 1936, inclusive.

The question presented by the record is one of exemption from income taxation, viz: Was petitioner exempt from the payment of income taxes for the years in question under the provisions of paragraph (11) of a section, identical in each of the Revenue Acts of 1928, 1932, 1934 and 1936, which provided that farmers' or other mutual fire insurance companies shall be exempt if their income is "used or held for the purpose of paying losses or expenses". (Appendix, P. 26).

The facts open for consideration in the Circuit Court briefly were as follows:

Petitioner is a fire insurance company which was chartered by the Court of Common Pleas of Washington County, Pennsylvania, on December 8, 1873, under the provisions of the Pennsylvania Act of April 2, 1856, P. L. 211 (R. 20). It has never issued any stock and there never have been any stockholders (R. 68). It has issued only one kind of insurance policy, viz., for term insurance, the terms ranging from thirty days to five years (R. 67).

The charter provided that the business should be conducted upon the "mutual principle, exclusively", that petitioner was "allowed" to insure on the cash premium system but that "insurance thus effected shall not entitle the insured to membership" nor subject the insured to payment of assessments (R. 20). From the date of its organization in 1873 to 1911 all insurance was issued for a dual consideration, viz., an annual cash premium and a deposit note, the amount of the notes initially constituting the guaranty fund or back log. The necessity to maintain a guaranty fund or back log decreased as the surplus of petitioner gradually increased, so that from 1911 to 1914 deposit notes, as a consideration for the issuance of insurance, were abolished when the property insured was rated or protected (R. 32, 63). They were

further abolished as a consideration for the issuance of insurance in January, 1914 when the property insured was unrated or unprotected. Thus, during the years 1928 to 1936, inclusive, insurance was effected only for a cash premium (R. 63). The use of deposit notes was continued, however, after January 1914 in a few cases (i. e., 16 cases during 1928-1936)—not as a consideration for the issuance of insurance but as a necessary means, in the absence of amending the charter, of enabling petitioner to maintain a technical, if small, membership under the terms of its charter, which provided that insurance effected for merely a cash premium would not entitle the insured to membership. Thus, a few deposit note makers constituted themselves a technical membership beginning in January, 1914.

During the years in question the average number of deposit note makers was 16, the average number of policyholders was 3,000, the maximum amount of deposit notes was approximately $8,700, the average amount of insurance in force was approximately $10,000,000 and the surplus and reserves ranged from $247,113.19 to $464,206.21 (R. 64, 65 and 67). The amount of the deposit notes was not carried as an asset on the books of petitioner after 1910 and no demand for their payment was ever made (R. 65).

Petitioner's income was not used or held for the purpose of paying dividends. It was used or held for the purpose of paying losses or expenses (R. 68). No dividends or returns of any nature were ever paid or made either to the deposit note makers or to the policyholders (R. 67). No assessment has ever been made against anyone (R. 68).

Each of the deposit note makers since January 1914 has been a policyholder. These deposit note

makers elected from their own group a board of directors, which board in turn elected the officers. The personnel of these deposit note makers was determined by the board of directors (R. 64, 65). Thus the deposit note makers have been a more or less self-perpetuating group since January, 1914.

In these circumstances, the District Court concluded that the 16 deposit note makers were not the owners of petitioner during the years here involved (R. 69), that it would be surprising naïveté to think that sixteen individuals could take over the company by each of them scratching his name to a meaningless piece of paper (R. 72), that the policyholders constituted the only group of persons really interested in the company (R. 69), that they were the real members as long as they held policies of insurance, that the company was not to be treated as virtually a stock company (R. 73), that there were not two or more classes of policyholders (R. 69), that petitioner did not use or hold its income for the purpose of paying dividends but "for the purpose of paying losses or expenses" (R. 68), and that it was such a mutual fire insurance company as was entitled to exemption (R. 68).

Under Section 12 of the Pennsylvania Act of April 2, 1856, P. L. 211 (R. 87), a fire insurance company chartered upon the mutual principle exclusively was required to issue certificates of proportionate shares in surplus to member policyholders and under Section 14 of the same Act such company was given the discretion to redeem such certificates with surplus in excess of $250,000. The Circuit Court relied heavily on this $250,000 limit and on the provisions for the issuance and redemption of certificates in determining a fact, viz., the "purpose" of holding income. It held that there was "no doubt" that the surplus was being held "for

the benefit of the members", meaning the 16 deposit note makers (R. 88), because "throughout" the years in question, the amount thereof being "far" in excess of $250,000, the failure to issue and/or redeem such certificates would amount to an abuse of discretion. This Pennsylvania Act, however, was "absolutely" repealed by the Pennsylvania Act of May 17, 1921, P. L. 682, 40 P. S. § 991 (Appendix, P. 30), and almost seven years before petitioner's surplus and surplus reserves reached the mark of $250,000 (R. 67).

The Circuit Court felt that prior to 1911 petitioner was "strictly mutual" (R. 90) but that during the years involved it was not. It also felt that the designation of deposit note makers as members was controlling and that this feature proved that petitioner insured property, even after January, 1914, upon two different bases —one being the consideration of a cash premium and the other being the consideration of a deposit note—and that consequently the business was conducted upon a dual basis which destroyed mutuality (R. 90).

The Circuit Court reversed the findings of fact of the District Court as to the purpose of holding income, as to the nature of the consideration for issuing insurance and as to the conditions under which insurance was issued since January 1914—these reversals having been made without any comment or ruling upon the existence of evidence to support the District Court's findings.

Jurisdiction.

1. This Court has jurisdiction to grant the writ of certiorari and to review the case by virtue of the provisions of Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stats. 938), and later amendments.

2. The jurisdiction of this Court is also invoked under Section 1141 of the Internal Revenue Code (U. S. C. Title 26, Section 1141).

3. The District Court entered judgment for petitioner on June 27, 1939. Upon appeal by respondent the Circuit Court of Appeals reversed the judgment of the District Court and entered its judgment for respondent on February 27, 1940.

The Questions to Be Presented to This Court.

Should the writ of certiorari be granted, the questions to be presented are:

1. Did Congress intend (by the provisions of Section 103 (11) of the Revenue Acts of 1928 and 1932 and Section 101 (11) of the Revenue Acts of 1934 and 1936) to exempt from income taxation only a pure mutual fire insurance company, as such, or rather a type of mutual fire insurance company?

2. May a *de facto* trusteeship, as such, qualify for exemption under such statutory provisions?

Reasons Relied on for the Allowance of the Writ.

Your petitioner submits that the writ of certiorari should be allowed in this case because:

I. *The Circuit Court of Appeals has in two respects so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.*

(1) Where the departure, as here, takes the form of reviving, for use in and as an important basis of its opinion, the dead provisions of a repealed state statute, the Circuit Court would seem to have indulged in judicial legislation. Since the wisdom of legislation is not a matter with which courts are concerned, the wisdom of the repeal of legislation is also not a matter of judicial concern. Where a court draws its own line at $250,000 and observes that the holding of surplus in excess of that amount is a legal discretion which may not be abused, and then decides that the continued and unqualified holding of surplus by petitioner of far more than $250,000 during the years 1928 to 1936 leaves no doubt that the purpose was to hold the surplus for the benefit of the holders, it would seem clear that there has been a merger of legislative and judicial powers in the court. Such merger is probably violative of Section I, Article I, of the Constitution and also of the due process of law clause of the Fifth Amendment. *Wayman v. Southard,* 10 Wheat. 1, 46; *License Tax Cases,* 5 Wall. 462, 469; *Prentis v. Atlantic Coast Line Company,* 211 U. S. 210, 226, 29 S. Ct. 67, 69; *Home Building & Loan Association v. Blaisdell,* 290 U. S. 398, 447, 54 S. Ct. 231, 243.

(2) Where the departure, as here, consists of the exercise of an absolute right of review of the findings of fact of the trial court, the Circuit Court would appear

to have disregarded a rule long and firmly established in our system of administering justice. In its opinion the Circuit Court neither commented nor ruled upon the sufficiency of the evidence to support the District Court's findings of fact. In the absence of such comment or ruling, the reversal would appear to be based upon a mere disagreement as to the weight of the evidence.

The District Court found as a fact that the income of petitioner was not used or held for the purpose of paying dividends but was used or held for the purpose of paying losses or expenses. The purpose in doing something is a fact. This fact is highly material, for it differentiates a pure mutual from the type of mutual Congress intended to exempt. The Circuit Court found the purpose of holding surplus (income) to be this, viz: for the benefit of the deposit note makers. There was ample evidence to sustain the District Court's finding.

The District Court also found as a fact that since January 1914 all properties have been insured by petitioner for a single consideration, viz., an annual cash premium. The Circuit Court found that petitioner has insured property since January 1914 for a cash premium and also for a deposit note. Here, too, there was ample evidence to sustain the District Court's findings.

The District Court further found as a fact that a policyholder received the same kind of insurance and paid for it in the same manner as every other policyholder and *regardless* of whether or not he signed a deposit note. The Circuit Court found that insurance policies were issued and received under different conditions, *depending* upon whether or not an applicant signed a deposit note. There was ample evidence to sustain the finding of the District Court.

Where a case is tried by the court without a jury, its findings of fact are not subject to review by the Circuit Court of Appeals if there was any evidence upon which such findings could be made. *Stanley v. Supervisors of Albany,* 121 U. S. 535, 547, 7 S. Ct. 1234, 1237; *Hathaway v. Cambridge National Bank,* 134 U. S. 494, 498, 10 S. Ct. 608, 610; *Dooley v. Pease,* 180 U. S. 126, 131, 21 S. Ct. 329, 331.

II. *When the provisions of the repealed Pennsylvania Act of April 2, 1856, P. L. 211, are ignored and when the reversed findings of fact of the District Court are restored, the decision of the Circuit Court of Appeals is based upon probably untenable grounds.*

(1) The Circuit Court seems to have taken it for granted that only a pure mutual was intended for exemption. If Congress had intended to exempt only a pure mutual, it would have been unnecessary to say anything about the purpose for which income should be used or held. Indeed, a pure mutual is taxable. A pure mutual usually pays dividends to policyholders, and since this is operating for gain, it is not exempt. *MacLaughlin v. Philadelphia Contributionship for Insurance of Houses from Loss by Fire,* 73 Fed. (2d) 582 (certiorari denied 294 U. S. 718, 55 S. Ct. 544). Congress intended to exempt a company, like petitioner, which uses or holds its income from all sources solely for the purpose of paying losses or expenses if it is otherwise mutual. That Congress limited exemption to pure-mutuals is, we believe, an untenable ground.

(2) The Circuit Court deemed the title of membership in the 16 deposit note makers as controlling. It did not, however, go so far as expressly to award the company to these 16 individuals, and yet, if they are the only real and beneficial members, they must be the own-

ers and such an award should be made. The deposit note makers operated petitioner in nowise for their own benefit but solely for the protection and benefit of the policyholders. They so testified. The policyholders were the real members. The exercise of voting and management privileges by 16 deposit note makers was conduct which was not incompatible with the usual conduct of trustees. A *de facto* trust may qualify for exemption. The view that both legal and beneficial interests must unite in policyholders in order for the company to be considered mutual is probably untenable.

WHEREFORE, your petitioner prays that a writ of certiorari issue out of and under the seal of your Honorable Court, directed to the United States Circuit Court of Appeals for the Third Circuit, directing that Court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in the case numbered and entitled *William Driscoll, Collector of Internal Revenue, Defendant-Appellant v. Washington County Fire Insurance Company, Plaintiff-Appellee,* No. 7221 October Term, 1939, and that the said Decree of the United States Circuit Court of Appeals for the Third Circuit may be reversed by your Honorable Court, and that petitioner may have such other and fur- their relief in the premises as to your Honorable Court shall seem meet and just.

And your petitioner will ever pray, etc.

WASHINGTON COUNTY FIRE INSURANCE COMPANY,

By WILLIAM G. HEINER,
Counsel for Petitioner.